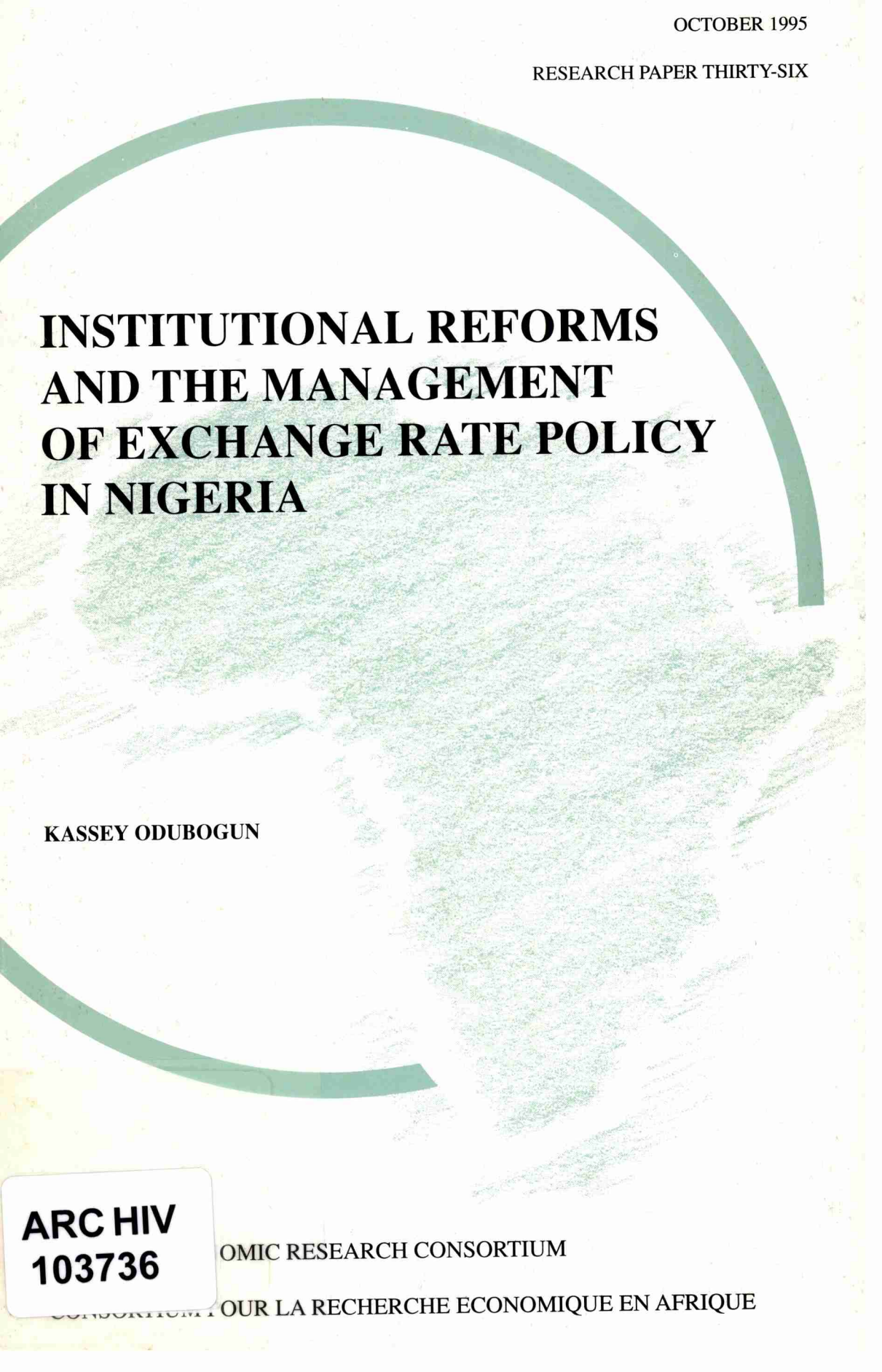


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INSTITUTIONAL REFORMS AND THE MANAGEMENT OF EXCHANGE RATE POLICY IN NIGERIA

KASSEY ODUBOGUN

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Institutional reforms and the management of exchange rate policy in Nigeria

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Institutional reforms and the management of exchange rate policy in Nigeria

Kassey Odubogun
University of Ibadan

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Abstract

A market determined allocation of foreign exchange (FOREX) and the exchange rate is considered necessary to an improvement in the competitiveness of the Nigerian economy both internally and in its trade and financial transactions with the rest of the world. However, the realisation of the advantages of the market by an economy depends on the functional character of its markets and its public institutions. This study has therefore analysed from an institutional perspective, the evidence on Nigeria's FOREX management and exchange rate policy from 1960 to 1990. The outcome of each policy regime was compared in terms of (a) the trend in exchange rate (b) degree of exchange rate premium and (c) structure of FOREX allocation. Evidence suggests that in spite of the reform of 1986, the naira exchange rate is still not competitively determined and the allocation of FOREX remains inconsistent with the requirements for the long-term development of the Nigerian economy. Evidence also indicates that the post-reform exchange rate policy has been adversely affected by government's expansive fiscal and monetary policy. The major conclusion of the study is that given government's macroeconomic policy and the character of the markets within which FOREX was traded and the linkages between them, the naira exchange rate has little chance of convergence and as a result, the possibilities for distortions in the allocation of FOREX remain very high.

I Introduction

The late 1970s and early 1980s witnessed a period of chronic macroeconomic decline in most least developed countries (LDCs) as evidenced by the stagnation of their economies, internal structural imbalances and severe external imbalances. These problems seem to have been more severe in Sub-Saharan Africa (SSA) countries, whose economies have been exposed to greater external and domestic economic shocks (Obidegwu, 1990). These crises have necessitated radical changes to reduce distortions in the economies in the face of mounting domestic and external pressures.

One crucial area of radical change for most of these countries has been their foreign exchange rate policy; it was believed that all or most of their currencies were over-valued due to the policy of fixed exchange rates which they adopted. In response to this need for major changes, many SSA countries modified their exchange rate regimes to make them more flexible and responsive to current economic conditions (Ndulo, 1990). Such modifications have included steep devaluation, adoption of crawling peg regimes and the auctioning of available foreign exchange resources. "In broad terms, developing countries that have adopted any form of the flexible exchange rate system option are those suffering from severe balance of payments difficulties compounded by accumulated external payments arrears who, in addition, lack official foreign exchange reserves needed to support a fixed exchange rate which has come under intense market pressure" (Oyejide, 1989). Table 1 gives some detail of some developing countries' choice of floating market arrangements.

Since independence, Nigeria, like most LDCs, has practiced a system of exchange control, until the drastic change in 1986, when a more flexible exchange rate regime was introduced. Before the introduction of the Structural Adjustment Programme (SAP) in 1986, Nigeria's economy was characterized by serious structural distortions and external imbalances. These have been linked to the overvaluation of the naira. Another causal factor is the collapse of international primary commodity market prices including that of oil, on which Nigeria was strongly dependent. Towards the end of 1985 to early 1986, the Nigerian government, rather than continuing with the ad-hoc policy measures which had been tried in the past for economic recovery, decided to undertake a comprehensive structural adjustment programme, the bedrock of which was a more flexible foreign exchange rate system. It was decided that auctioning the available foreign exchange (FOREX) resources via the market would be the best method of achieving a realistic external value for the naira.

The Second-Tier Foreign Exchange Market (SFEM) was an element of the SAP introduced in September 1986. It aimed at evolving a sustainable market-determined

exchange rate for the naira. The decision to introduce the SFEM, with the auction system as the operative mechanism, was taken as part of the adjustment policies to correct the distortions in all major sectors of the economy, reduce imports, stimulate exports, especially of non-oil goods, and pave the way for economic growth (CBN, 1986).

This decision marked a major shift in exchange rate policy and in the management of foreign exchange resources. To appraise the effectiveness of this change, it is necessary to document the institutional reforms and their particular implications for the allocation of FOREX and the determination of the rate of exchange of the naira.

The purpose of this study is to report, from an institutional perspective, Nigeria's experience of using the auction system in the allocation of foreign exchange, as a way of arriving at 'a realistic exchange rate'. In addition, the various modifications to the system at different stages of the SFEM and the causal forces will be identified and analyzed.

Section II briefly discusses the research framework that provides the basis for the analysis carried out in later sections. Section III is a chronological report of the Nigerian foreign exchange policies from 1960 through 1990. The major emphasis is on the institutional framework through which FOREX rates have been determined. Section IV presents post-reform FOREX allocating mechanisms, highlighting the market types, operators in the different markets and what convergent rules were in place in the markets over the period of the study. The last part of Section IV evaluates the competitiveness of the FOREX markets and the consequence of this for a homogeneous, and hence competitive, exchange rate. In Section V, a comparative analysis of the pre- and post-reform periods will be done. This analysis will, among other things, compare exchange rate trends, the differentials among various market rates, and the allocation of FOREX on a sectoral basis during the two periods under comparison. The last section of the paper summarises the major findings of the study and draws some general conclusions.

Table 1: African members of IMF operating market-related floating exchange initiative: Characteristics

Country	Form of Arrangement	Rate Determination	Role of Central Banks's Intervention
Gambia, The	Interbank (daily)	Negotiation between banks and their clients	No intervention to influence exchange rate
Ghana	Auction (weekly)	Dutch Auction	Possibly by adjusting supply
Guinea	Auction (weekly)	Marginal Pricing	Possibly by adjusting supply within constraints of external debt obligations
Nigeria	Interbank and Auction (daily)	Negotiation between banks and clients and marginal pricing	None in interbanks; variation of supply to auction market
Sierra Leone	Interbank	Negotiation between banks and clients	None
Uganda	Auction (weekly)	Marginal Pricing	By adjusting amount of supply to auction market
Zaire	Interbank (daily)	Negotiation between banks and clients	Some intervention on interbank market
Zambia	Auction (weekly)	Dutch auction	By adjusting enough of supply of auction within external debt servicing constraints

Source: J.P. Quirk *et al.*, 1987, "Floating Exchange Rates in Developing Countries: Experience with Auctions and Interbank Markets", *IMF Occasional Papers*, No. 53, Washington D.C., I.F.

II. Research framework

The purpose of this section is to specify the framework within which this study is conducted. It also identifies the relevant theoretical issues that are of critical importance to the study.

The study deals essentially with a macroeconomic policy instrument, the exchange rate. The character of macroeconomic policy is therefore of relevance to the study. The main features of macroeconomic policy are: 1). multiplicity of goals and instruments and 2). conflict among policy goals. It is to be expected that policy instruments would be inter-related. As a result, exchange rate policy, which is an element in the set of macroeconomic policies, would be closely associated with other elements of the set, i.e. fiscal, monetary, income and trade policies. The realization of the objectives of macroeconomic policy would invariably require a consistent macroeconomic policy environment. This seems to explain why the Nigerian government decided to adopt certain fiscal, trade and monetary policies when it decided to alter the direction of exchange rate policy in the third quarter of 1986.

It is useful to identify the specific character of the linkages among macro policy instruments before policies are articulated. The issue of the institutional framework of policy is an important aspect of this inquiry. In fact, a relevant causal analysis needs an understanding of the basic institutional framework of the various macro policy instruments. A characterization of the institutional framework of Nigeria's exchange rate policy is, therefore a relevant step in a causal analysis.

Exchange rate refers to the *price* of a domestic currency relative to a foreign currency. It assumes relevance largely because of the cross-border flow of commodity and financial assets. The particular policies adopted by each country would, as a result, have consequences for its trade relations with other countries.

Since exchange rate is a price, the important consideration is the mechanism for its determination. The mechanism through which exchange rate is determined reflects the exchange rate policy of nations.

In the theoretical literature, there are two major mechanisms. The distinguishing feature between the two is institutional, which explains why the mechanisms correspond to the two major economic institutions in real economies, i.e., the government and the market. The government may dominate market mechanisms such that, independent of the market, it determines, or more appropriately *fixes*, the rate of exchange. This is more likely to be associated with control regimes. Where the government allows the market institution free rein, the exchange rate is determined through the market process. Arguably, each regime reflects the dominant economic philosophy of the state.

Fixed exchange rates tend, as a result, to be associated with controlled economies, while flexible exchange rates tend to be associated with liberal economies. This is

why, to a large extent, a shift in policy, e.g., from fixed to floating, may require a shift in economic philosophy.

There is intense controversy on the effectiveness of the two regimes that determine the exchange rate. This centres around the extent to which each regime facilitates domestic and external economic balance. The exchange rate is conceptualized as a link between the price structures of nations and, as a result, is important to patterns of international commodity flows and the international mobility of capital resource (Bogunjoko, 1991).

Before the arguments supporting each exchange rate determination mechanism are highlighted, it may be useful to distinguish between the real and the nominal exchange rates. Real exchange rate expresses the value of the domestic currency in terms of real purchasing power. The ratio of the domestic prices of two economies measures real exchange rate. The nominal exchange rate expresses the quantity of one currency in terms of another, e.g., N:\$.

The real exchange rate is perceived as sending the right signals which induce the correct structures of domestic and external absorption and production (see Levich, 1985 and Oyejide, 1986). Given this premise, the contention in the controversy revolves around the extent to which the nominal exchange rate, which is what is actually directly determined (in any exchange rate regime), varies from the real. If the variance is non-zero, the implication is that the mechanism for determining the nominal exchange rate is distortionary.

Ojo (1990) emphasized this when he insisted that: 'an inappropriate exchange rate ... tends to create instability in the FOREX market and to perpetuate widespread distortions in international economic transactions'.

Theoretically, the fixed exchange rate regime which is operated by the government through its monetary authorities (who determine the nominal exchange rate independent of the market) is analyzed as potentially distortionary. This distortion manifests itself either in over-valuation or under-valuation. More often, particularly in the case of LDCs, the problem is overvaluation. Because it stimulates import demand and suppresses export supply, it creates disequilibrium in the FOREX market and deficit in trade balances. Thus, as is usual with price control, a broader set of controls are necessitated by the resultant disequilibrium.

Exchange rate controls were, however, the dominant policy in Nigeria before September, 1986. This policy seems to have been adopted because of arguments that exchange control ensures the stability of the currency. Ward (1965) emphasized this attribute of a fixed exchange rate regime. Even more fundamental, Johnson (1970) and Todaro (1977) argue that given the structure of LDCs, the optimal exchange rate policy is a fixed rather than a flexible exchange rate regime. Todaro (1977), made the point thus: "flexible exchange rates are not thought to be desirable especially in the Third World ... because they are unpredictable ... and susceptible to foreign and domestic currency speculation. Such unpredictable fluctuations can wreak havoc with both short and long-range development plans".

The proponents of a flexible exchange rate deny the propositions that fixed regimes generate exchange rate stability and economy wide benefits. Quirk (1989), Odozi

(1986) and Dibua (1990) argue that a fixed exchange rate regime cannot guarantee stability since, as Quirk puts it, the rates must be adjusted from time to time. Odozi (1986) argues that pegged currencies often float against other currencies. Odozi and Dibua (1990) assert that the cost of controls and the rules governing FOREX allocation generate high inefficiencies in the FOREX market, and hence the economy. Generally, a flexible regime, an antithesis of controls, is seen to generate efficient FOREX allocations and thence efficient resource allocation and use within economies.

The historical experiences of countries have shown that some economies have, at given points, adopted more than one exchange rate regime, or have adopted an eclectic regime which taps the advantages of the two extreme regimes. A dual exchange rate regime is an example of the former, and an adjustable peg, of the latter. These notwithstanding, the two institutional frameworks, i.e., government and the market, are the mechanisms for determining exchange rates. An efficient exchange rate regime may therefore depend, among other things, on the character of the institutions and operational efficiency of the institutions. As a result, this study intends to identify and describe the operational structures of the Nigerian institutional framework of exchange rate determination. This is necessary for an analysis of the effectiveness of exchange rate regimes in Nigeria. The paper goes beyond theoretical generations to examine whether, given the specific structures of Nigeria's market, 1. a market directed allocation of FOREX is growth inducing; and 2. a market determined exchange rate is competitive.

The shift in Nigeria's exchange rate policy from controls to deregulation has made the market mechanism dominant in the management of FOREX. The extent to which the market approximates a competitive market becomes critical to achieving a competitive exchange rate and an efficient allocation of FOREX. Moreover, a homogeneous rate would necessarily require the essential characteristics of a competitive market, i.e., free entry and exit, perfect information and perfect mobility, or at least approximations of these attributes. These issues guide the analysis of market types in Section IV.

III. Nigeria's foreign exchange policy: 1959-90

The documentation of the FOREX policy in Nigeria is carried out over two distinct periods. The first period - 1959 to mid-1986 - was when the fixed exchange rate policy was adopted in Nigeria. From July 1986 there was a sharp departure from the fixed exchange rate regime to a more flexible regime. The institutional framework for FOREX allocation is the basic distinguishing feature of both periods, as it shall become apparent.

Between 1959 and mid-1986

The first phase of the Nigerian exchange policy began in earnest in 1959 with the establishment of the central bank of Nigeria (CBN). The CBN was specifically set up to manage the country's currency with the objective of attaining a sound and stable national currency. Using the pegged exchange rate system, the Nigerian pound was fixed by the 1958 Central Bank Ordinance at par with the pound sterling (Obaseki, 1991). It was the CBN's responsibility, as stated in the ordinance, to buy and sell its currency on demand at this rate. Later on, in 1962, the exchange control act was enacted by the CBN, which vested the Minister of Finance with the authority to grant approvals in respect of FOREX transactions, while the CBN handled private sector transactions through authorized dealers (commercial banks).

The 1962 Act, rather than allowing the Nigerian pound to be fixed at par with the pound sterling, was defined in terms of gold, which meant that Nigeria could, at any time, decide on whatever adjustments needed to be made in the official rate between its currency and other currencies. This, of course, was supposed to send strong signals to the international community that Nigeria as an independent nation was free to take decisions on her own. The wisdom of the action was later justified when, in 1967, the pound sterling was devalued without any effect on the Nigerian pound, which was at the time autonomous.

In 1973, the Nigerian currency was decimalized and changed from the pound to the naira. This time, seemingly forgetting the wisdom of autonomy, the exchange rate was fixed to the US dollar. When the US dollar was devalued in 1973, the value of the naira also fell because of its direct relationship with it. This became an issue of concern when the dollar persistently depreciated. By the end of 1973, the Nigerian government decided to discontinue any direct relationship between the naira and either the pound sterling or the US dollar.

Between 1974 and 1975, the decision of Nigeria to manage its own currency, independent of the fortunes of the pound sterling and the US dollar, led to the adoption

of a “policy of progressive appreciation” of the naira. This policy was greatly enhanced by Nigeria’s strong position from increased earnings from crude oil exports. To further minimize the effect of fluctuations of exchange rates of other major currencies on the naira, a policy of pegging to a basket of international currencies of seven of Nigeria’s partners; the United Kingdom, United States, Germany, France, Japan, Switzerland, and the Netherlands; was adopted. This was expected to stabilize the effective exchange rate of the naira under the assumption that the loss in value due to the devaluation of one currency in the basket would be compensated by the appreciation of another currency in the same basket. This arrangement was thought to have the advantage of dampening the effect of the external exchange rate changes on prices and the balance of payments (BOP).

It is important to note that from about 1973 to late 1977, Nigeria had accumulated sizeable foreign reserves arising from the oil boom, which made it possible for the fixed exchange rate policy to be managed through reserve movements. Official reserve depletion helped to meet private excess demand; however, there was a reluctance to devalue when the reserve later became too low to support the fixed exchange rate. To curb the situation, FOREX from the Central Bank was strictly rationed and controlled through an import licensing system meant to protect official reserves. The problem was that when the level of reserve increased, the naira appreciated, but was never allowed to depreciate when the reserve level fell. This gave an impression that a continuous drain on the official reserves could sustain an overvaluation of the naira. To reverse this trend, strict exchange control measures were adopted, which were:

- Reduction of consultancy and technical fees remittable by foreign consulting companies from 60% to 50%;
- Reduction of business trips from 15 to 14 days maximum per trip;
- Reduction of basic travel allowances to pilgrims and other travellers; etc.

Attempts were also made to adopt schemes that would ensure the success of the exchange control measures, such as:

1. The establishment of the exchange control (anti-sabotage) decree of 1977 which established some tribunals to try FOREX offenders;
2. From 1979, the establishment of the Comprehensive Import Supervision Scheme (CISS) to ensure a preshipment check on prices, volume and quality of imported goods worth over US\$33,000. The scheme was also expected to check other FOREX malpractices, such as:
 - Overloading of invoices for the purpose of transferring FOREX abroad;
 - Under-invoicing of imports to pay less import duties;
 - Importation of obsolete plant and machinery at the prices of new ones;
 - Importation of out-dated and rotten food items and expired drugs;
 - Falsification of documents;
 - FOREX claims for goods not imported or services not rendered;
 - Overpricing of federal government projects with a view to keeping the gains abroad in FOREX; etc.

From 1980 to 1981, the degree of exchange control was reduced, largely due to an improvement in the BOP brought about by positive developments in the international oil market. This soft-peddalling was also due to the difficulty associated with tight exchange control regulations. The relatively liberal system of exchange controls in the early 1980s was mainly aimed at curbing rampant abuse and malpractices in respect of FOREX transactions, such as over-invoicing of import bills, smuggling of currencies and goods across the borders and false documentation of import bills. Because the policy was not sustainable, controls had to be tightened again.

The period between 1982 and 1986 marked the last phase of exchange control in Nigeria. The stringent exchange control measures, as in earlier periods, was preceded by severe BOP pressures. As part of the global economic recession, Nigeria at this time was experiencing severe economic difficulties. FOREX receipts both from oil and non-oil exports were consistently less than the disbursements for imports. Between 1981 and 1984, for example, the total exports receipts figures were less than the total imports (see Table 2). This led to a slide in the external reserves. Because short-term external loans were used to finance these deficits, external debt began to accumulate.

Responding to the severe economic pressures of the late 1970s and early 1980s, the Economic Stabilization Act of 1982 was passed with the aim of correcting the BOP problems and the distortions in the domestic production and consumption pattern. The Act provided for:

- Reduction of business travel allowance from ₦3,000 to ₦2,500 per annum for registered companies;
- Re-imposition of pre-shipment inspection for raw materials, spare parts, books and fish;
- Reduction in repatriable consultancy fees from 30% to 20%; etc.

Despite the exchange control measures of the 1982 Act, evidence indicates that the Nigerian external sector continued to experience problems, primarily due to the development in the international oil market which caused the price of oil to fall and FOREX earnings to decline. Statistics (see Table 2) show that despite the 1982 Act, total export earnings reduced from US\$14,951.2 million in 1982 to US\$11,679.2 million in 1983. While the total imports for 1982 was US\$ 17,095.6 million, in 1983 it was US\$ 12,095.6 million, a reduction caused by the stringent controls on imports. Despite the reduction in imports the debt service ratio for 1983 was 17.5%, as compared to 8.9% in 1982.

In 1984, exchange control measures were even tighter, partly due to the growing external debt outstanding which totalled US\$19,021.14 million in 1984, up from \$14,620.49 million in 1983. In 1984 and 1985, other restrictive measures were introduced. These included regulatory administrative measures such as the Form "M" registration, monitoring of import licence use, and matching the value of import licence with the FOREX budget for imports. Other measures included the prescription of a "management"

Table 2: Selected macroeconomic indicators for Nigeria: 1970-90 (US\$ million)

Year	Oil exports	Total exports	Total imports	External debt Outstanding	Debt service ratio (%)	External reserves
1970	N.A.	901.6	829.9	68.43	3.5	218.96
1971	N.A.	1,495.3	1,315.6	308.88	2.3	405.22
1972	N.A.	1,818.5	1,877.5	400.37	1.8	370.27
1973	2,605.6	3,399.89	2,755.9	420.89	1.3	574.56
1974	7,067.4	8,442.2	3,473.0	515.33	0.5	5,199.56
1975	7,719.7	8,917.3	8,959.5	568.38	0.7	5,490.63
1976	8,698.0	10,502.6	11,014.3	597.86	0.5	4,879.93
1977	9,975.9	12,003.8	12,807.5	768.51	0.3	3,895.42
1978	8,287.5	12,538.4	14,749.1	2,063.71	2.7	1,965.48
1979	14,503.5	17,351.0	14,280.4	2,673.64	1.7	5,048.64
1980	22,932.6	25,979.3	21,586.2	3,413.63	0.7	9,957.09
1981	17,471.5	21,449.2	26,443.8	3,854.41	5.0	4,009.16
1982	12,178.5	14,951.2	17,028.5	13,102.10	8.9	1,524.97
1983	10,192.5	11,679.2	12,095.6	14,620.49	17.5	1,002.37
1984	11,016.1	12,121.4	11,656.9	19,021.14	29.1	1,413.18
1985	11,367.2	12,310.2	11,731.7	19,375.85	33.2	1,839.02
1986	5,742.5	6,979.5	6,481.9	32,606.07	29.4	2,821.85
1987	4,659.2	5,510.3	5,312.8	25,388.93	11.9	1,169.75
1988	4,924.9	5,229.2	5,561.9	32,195.24	25.7	721.30
1989	5,912.3	6,984.7	5,837.0	32,645.45	23.1	1,827.47
1990	7,437.1	9,562.1	7,437.6	37,058.05	31.3	4,348.16

Source: Central Bank of Nigeria, *Annual Report and Statement of Accounts* (various years).

system of allocation of FOREX on a sectoral and monthly basis. The FOREX market was liberalised through the introduction of an import licence not valid for FOREX, by which imports, financed through off-shore sources, were allowed.

A strict exchange control was maintained throughout 1985 to mid-1986 with some modifications made in 1986. New measures were put in place to improve on what already existed, such as:

- The suspension of the BTA pegged at ₦2,500 per annum for registered companies in 1983;
- The re-enforcement of the 1977 anti-sabotage decree;
- An embargo on external borrowing, except for projects deemed crucial to the survival of the public interest;
- A ban on importation of some commodities, such as rice and maize, with effect from 1st October 1985.

There is no doubt that these strict control measures were progressively intensified until mid-1986 in a desperate attempt to control the allocation of a declining inflow of FOREX.

Because exports are the major determinant of FOREX inflow, the Nigerian government throughout the period in question tried to promote them. This was considered even more important given the heavy dependence of the Nigerian economy on the external sector. The authorities, therefore, considered it important not only to promote exports but to diversify the export base. This led to the promulgation of the 1976 exports promotion decree giving legal backing to all exports incentives already introduced. As a result the Export Promotion Council was established to promote Nigeria's non-oil exports and diversify the export base. At the same time, the marketing boards already in place were dissolved and replaced with commodity boards in 1977. The 1986 Federal Government budget contained proposals for the establishment of export free zones and import duty concessions for export manufacturing. Although several packages of incentives followed these budget proposals, such as the retention of 25% of export proceeds by exporters in a bid to promote exports, many of the incentives were never implemented.

The management of the exchange value of the naira in 1985 to mid-1986, as in the few preceding years, had two major objectives. The first was that it should reflect the fundamental economic conditions of the country, which was experiencing serious BOP problems. The second was that the exchange value should respond to movements in the other exchange rates in the international exchange markets. It became apparent during the middle part of 1986 that the ad-hoc measures established to correct the severe crisis, had proved incapable of resolving it. The policy response was therefore a shift away from an exchange control regime to a market-directed or deregulated regime.

Between Mid-1986 and 1990

In place of the exchange control regime prevalent between 1959 and mid-1986, a liberalized system was introduced in July 1986 within the framework of an SAP. Among others, the SAP aimed to 1. achieve fiscal and BOP viability; 2. lessen the dominance of unproductive investments in the public sector by a rationalisation of public enterprises through privatization and commercialization; 3. reduce the level of unemployment; and 4. bring the economy back on the path of steady and balanced growth (CBN, 1986). Attempting to achieve BOP and fiscal viability generated the need for a market-determined exchange rate mechanism - the Second-Tier Foreign Exchange Market (SFEM) - and the adoption of fiscal austerity and monetary restraint, which theoretically are expected to induce the realisation of a BOP equilibrium. A liberal FOREX market is expected, theoretically, to impact positively on domestic production and absorption via an efficient exchange rate and, hence, allocation.

For this reason, the key policy element of SAP is the SFEM which was introduced in September, 1986. It had the following four main objectives:

1. To enable the naira find its true value;
2. To achieve an optimal allocation of FOREX resources through market-determined rates;
3. To eliminate gradually the parallel market;
4. To eliminate the vices associated with the import licence regime; etc.

SFEM was basically established to provide an institutional framework - the auction through which "a realistic market-determined exchange rate" could evolve (CBN, 1986). It was hoped that the rate so determined would eliminate the overvaluation of the Naira while, at the same time, reduce the excessive pressure on the limited foreign reserves which had significantly dropped by 1986 from the 1980 figure (see Table 2).

The key mechanism for FOREX management from mid-1986 to 1990 was the SFEM which was conceived within a market institutional framework - the auction for the determination of an appropriate exchange rate for the naira. The SFEM was expected to encourage an increase in domestic output and FOREX receipts, curtail FOREX expenditure and more specifically, result in a more rational allocation and utilization of FOREX resources and reduce FOREX volatility. In essence, it was expected that SFEM operation would make FOREX management less costly to administer, and more efficient to operate.

The Central Bank of Nigeria (CBN) has been the major source of supply to the SFEM since its inception, for the sole reason that it controls most of the nation's FOREX from the export of crude petroleum. Sales of FOREX in the SFEM made through deals concluded at periodic auctions between the CBN and the authorized dealers. The auction provided for bidding sessions where authorized dealers competed for available FOREX until a market determined exchange rate evolved.

The mechanism for determining the exchange rate of the naira is expected to induce a more rational use of Nigeria's scarce foreign exchange resource. This expectation is anchored on the theoretical benefits of the market mechanism. However, whether these theoretical benefits can be realised in Nigeria depends strongly on the character and the operational efficiency of the Nigerian market process. Thus, the degree of competitiveness of the market directly influences the size of distortions in the market. The point is that government controls do not have a monopoly over distortions: distorted and uncompetitive markets independent of government regulations generate distortions. A mere shift in policy by itself may therefore not be sufficient to induce efficiency.

Since the introduction of a liberal exchange rate policy, the institution of exchange rate determination has undergone periodic changes:

- In 1987, both the First-Tier and Second-Tier markets, which had simultaneously operated since July 1986, were merged. With this merger, a new market – the Foreign Exchange Market (FEM) – was created. This was operated solely by the use of the auction. However, alongside this, the banks were allowed to buy and sell FOREX between themselves, autonomously from the FEM.
- As a result of the abuse of the privileges by banks operating the autonomous market, in 1989 the autonomous market was abolished, Inter-bank Foreign Exchange Market (IFEM) emerged, and the auction was used as the pricing mechanism for FOREX. Also in 1989, the Bureau de Change was established to enlarge the scope of the officially recognised FOREX market with the main aim of making FOREX available to small users who were unable to compete for FOREX under the IFEM.
- There were also some changes made in the pricing policy under the auction, in a bid to make the market more efficient and to arrive at a “realistic exchange rate”. Over time, the pricing system has changed from average rate pricing system (ARPS), to marginal rate pricing system (MRPS), to the Dutch auction system (DAS) with marginal rate.

These changes and their effects on the operational efficiency of exchange rate determination are examined in more detail in the next section.

IV. The post-reform management of forex

Since September 1986 the market assumed prominence as the major institutional framework for managing FOREX. Between 1986 and 1990, three distinct markets within which FOREX was exchanged can be identified and they were:

1. Official market;
2. The bureau de change;
3. The parallel market.

Table 3 shows that all the markets have never co-existed simultaneously; rather, a combination of market types have been in operation at one point or another. The general pattern is, in fact, an evolutionary process of transformation in market structures over the period as indicated by Figure 1. It should be noted that of the market types identified, the parallel market, among other things, is informal, i.e., it does not operate within the context of any official regulation.

In tracing the evolutionary patterns in the FOREX process, the discussion will focus on key issues such as the objectives of the markets, the operators within each market type and what pricing policies exist in each market at specific points and over time. By the large, the reference point will be the degree of competitiveness within the exchange process. In this context, regulations/interventions and the reasons informing them will be identified and evaluated. This is necessary as intervention on its own is not adverse; what is distortionary are ad hoc interventions, i.e. those not based on a critical analysis.

Official markets

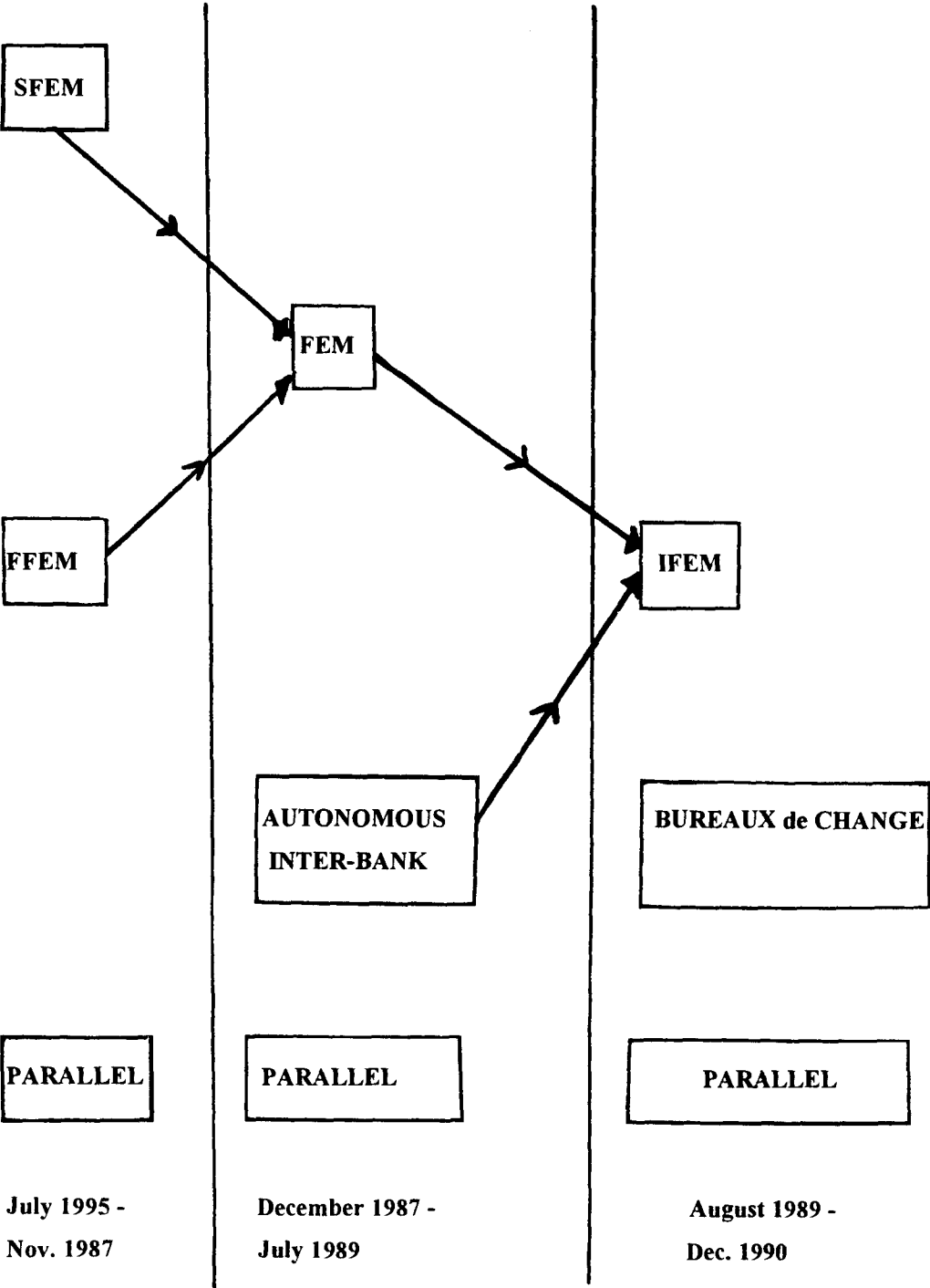
As can be seen from figure 1, the official¹ FOREX markets have been the First-Tier Foreign Exchange Market (FFEM), the Second-Tier Foreign Exchange Market (SFEM), the FOREX Market (FEM) and the Inter-bank FOREX Market (IFEM).

During the reform period, the FOREX administration started with a simultaneous operation of the FFEM and the SFEM. Although not a market in the real sense of the word, the FFEM was an arrangement whereby the CBN released FOREX to cover applications that have received prior exchange control approval by a competent authority. It was a fixed exchange rate market, while the SFEM was auction market. The five groups of transactions covered by the FFEM included:

Table 3: Major FOREX markets, 1986-90

Types of Markets							
Year	First-Tier Market	SFEM	FEM (Merger of 1st + 2nd Tier)	Autonomous	IFEM (merger of FEM + Autonomous Market)	Bureaux de Change	Parallel Market
1986	X	X					X
1987			X	X			X
1988			X	X			X
1989					X	X	X
1990					X	X	X

Figure 1: Evolution of FOREX market institutions, 1986-90



1. Transactions covered by a specific import licence issued in 1985 or 1986 for which a confirmed and irrevocable letter of credit had been established on or before the last day immediately preceding the commencement of SFEM;
2. Capital transfers, profits, dividends and other invisible payments for which approval had been granted before the SFEM commenced;
3. Public or private sector transactions relating to debt service obligations that were due and payable, official contributions and grants to international organisations and remittances to Nigerian missions abroad;
4. Net proceeds of air tickets sold by foreign airlines up to and including the last day immediately preceding SFEM's commencement, in as much as the first leg of the journey out of Nigeria had started before the date of SFEM's commencement;
5. Any transactions valid for foreign exchange in respect of which advance import duty on Form C188A had been paid, a Clear Report of Findings issued by the Inspection Agent, and a document submitted to the CBN for issue of cover not later than the last day immediately preceding SFEM's commencement.

All the first-tier transactions were to be settled by the CBN at the rates of exchange prevailing at the date when:

- All documentation collected from the CBN were submitted back to the CBN;
- The obligation to which the documentation relates had, having regard to the nature of such transaction, become due and payable; and
- The corresponding naira component of the transaction has been deposited with CBN.

It is important to note here that, during this early period, the FOREX source officially was made available to both the FFEM and SFEM. The CBN, had a monopoly in the official markets at this time. Sales of FOREX in the SFEM were made through deals concluded at weekly auctions at the CBN. The frequency of the auctions were reduced to fortnightly later in the process. The main distinguishing factor between the FFEM and the SFEM was the mechanism for the determination of exchange rates. This generated dual exchange rates. With the SFEM responding to guided market forces in a situation where demand for FOREX was always greater than supply, exchange rates soared far above the fixed FFEM rates. For example, at the first SFEM bidding session of 26 September 1986, while the FFEM rate was fixed at ₦1.5691:US \$1, the SFEM produced a rate through the auction of ₦4.6174:US \$1. This was a 66% depreciation of the SFEM compared to the FFEM rate. It was observed that this dual system of allocating FOREX was not competitive enough and that further modifications needed to be made to make the market more liberal.

As a result of this, in accordance with the SFEM Decree of 1986, the FFEM and the SFEM were merged on 2 July 1987 to form the FEM. This merger was expected to

enhance the competitiveness of FOREX allocation. However, alongside this modified version of what existed before, the CBN allowed banks to operate an autonomous FOREX market where Authorized Dealers could buy and sell FOREX at a market-determined rate without going through the CBN auction process or even confirming with CBN on a transaction-to-transaction basis. This was expected to improve business in the banks and to remove some of the delays and bottlenecks associated with the auction process. It was also expected that, by sourcing autonomously, the demand put on the limited supply in the official auction market would be reduced, thereby causing an appreciation of the naira in the official FEM market.

However, it was observed later that there was a widespread abuse of the deregulation of the market in the banking system. The Authorized Dealers kept the autonomous rates permanently high, reflecting a faster depreciation of the naira in the autonomous market than in the official FEM market. For instance, the autonomous rates during the period January to August, 1988, ranged from ₦4.3611 to ₦6.8800, while the rates in FEM were in the range of ₦4.1740 to ₦4.5440; the autonomous rate showing a premium of between 4.46% and 43.52% over FEM rates (see Table 7). This development led to a further modification that cancelled the existence of the autonomous market at the end of 1988.

In January 1989, the IFEM, a unification of FEM and autonomous markets was created. With the IFEM, the naira exchange rate at the bidding sessions became relatively stable. For example, the stability can be seen when one compares the monthly average of ₦7.089 in January 1989 to ₦7.6500 in December 1989 (see Table 6). The system continued in 1990 with an opening average rate of ₦7.820 in January, 1990, which slowly depreciated to an average of ₦8.7071 in December, 1990.

The whole process of FOREX acquisition and allocation under IFEM became very technical and sophisticated. Transactions in FOREX no longer ended with the scheduling of approved exchange control forms of CBN -unidirectional transaction aimed mostly at obtaining FOREX cover for imports, as with the regime of fixed exchange rate. The Authorized Dealers were much more involved in several areas of the operation, such as: rate determination, bid sessions, success rate, interbank dealings, across-the-counter deals and monitoring and managing FOREX balance.

Rate determination, for instance, requires a high degree of intelligence. Banks, in quoting for FOREX at IFEM, took several factors into consideration and crucial among these were competitors' activities and clients' willingness, ability and commitment to pay at the emergent rates plus spread.

Having a reasonable degree of success at bid sessions actually became a nightmare for FOREX dealers, given that the degree of success had a direct bearing on the bank's image, patronage and, therefore, profitability through income that was generated in the process. One notes that with IFEM, banks were more conscious than ever of the need to ensure high success rates of the auction market to satisfy their customers.

Participation in the official market

The principal participants in the official FOREX market are the Federal Ministry of Finance and Economic Development, the CBN, the Authorized Dealers - Commercial, Merchant and Development banks, reputable hotel and guest houses, and the Bureau de Change decreed in 1989.

The Federal Ministry of Finance and Economic Development is the approving authority of the FOREX process. It approves public and private sector transactions within its jurisdiction and has the major responsibility of the overall control of the SFEM. The ministry is expected to issue all necessary directives that are appropriate for the efficient operation of the market.

The CBN, empowered by the SFEM decree of 1986, has the responsibility of supervising and monitoring the operation of the FOREX market as well as issuing, from time to time, guidelines to regulate the procedures for transactions of SFEM, including the specification of the documents that may be tendered in support of an application to purchase FOREX in the market. The CBN is also the major supplier of FOREX to the market. Apart from controlling the money supply and the amount of FOREX offered for sale during each bidding session, the CBN also influences the movement of the exchange rate by a series of interventions in the market (see Table 5 for some of these interventions, the types of intervention and the objectives of the intervention).

The Authorized Dealers are the main 'consumers' in the auction. Their activities are conducted under the supervision of and rules and regulations issued by, the CBN. The Authorized Dealers approve private sector foreign exchange applications, make foreign exchange allocations to customers and transfer the funds allocated within the framework of the guidelines issued by the CBN. They are required to document all transactions in the interbank market in respect of transactions between their banks and the public, and to later submit returns on their transactions to the CBN. Those Authorized Dealers who fail to follow specified rules and regulations are guilty of an offence and liable to penalties which are spelt out in the Banking Act.

Hotels and guest houses are required to receive payments in FOREX from visitors to Nigeria for services rendered. The hotels and guest houses may then lodge such collections in foreign currency domiciliary accounts and use them for eligible transactions or sell them to Authorized Dealers. However, the hotels and guest houses are required to submit monthly returns on their FOREX purchases to the CBN.

Regulations in the official markets

During the fixed exchange rate era, the prevailing rates were administratively determined; the general guidelines or policy regulations were essentially an in-house matter for CBN officials. However, with the introduction of SFEM, there were some guidelines which regulated its operation. Guidelines under SFEM are issued to inform, educate and aid the Authorized Dealers and members of the public in the efficient operation of the

market. For example, the CBN regulations indicate that although anyone can buy and sell FOREX, there are Authorized Dealers whose responsibility it is to ensure that purely speculative transactions and others which are inconsistent with the set objectives of SFEM are not allowed. Regulation as to when FOREX can be sold and bought is also stated. Hours of business are specified to conform with normal banking hours. Guidelines are also issued to streamline procedures and to clarify misconceptions and ambiguity. For example, a guideline given by the CBN states that all foreign visitors to Nigeria shall pay their hotel and incidental expenses in foreign currency. However, where there is documentary evidence that an adequate amount of FOREX has been exchanged into local currency through licensed banks and/or Bureau de Change on arrival in the country, local currency will be accepted in settlement of bills by foreign visitors to Nigeria.

Apart from the original guidelines that were issued at SFEM's inception, other circulars were issued to the Authorized Dealers. The guidelines which form a part of the foreign exchange policy in Nigeria are being reviewed periodically in line with the prevailing circumstances and operation of the market.

Pricing rules

To try to make the market more competitive and to ensure proper allocation of available FOREX, several pricing policies have been adopted, especially given the modifications that have been made from "FFEM and SFEM" to "IFEM and autonomous market" to "IFEM". The three main pricing rules within the official markets (summarised in Table 4) are:

1. Simple average pricing;
2. Marginal rate pricing; and
3. Dutch Auction pricing.

During the first two bidding sessions on 26 September, 1986 and 20 October, 1986, the CBN used the *Simple Average Pricing* of the successful bid rates in selling FOREX to Authorized Dealers. However, marginal rate was used as a cut-off point to determine successful bidders. Because this pricing method was criticised for its inability to bring about a "realistic exchange rate", starting from the third bidding session, the *marginal rate* was used, not only to determine successful bids, but also to debit the account of Authorized Dealers on the sale of FOREX to them. The marginal rate was used as the reference point for defining the effective rate, the selling rate and the buying rate. All Authorized Dealers bought FOREX from the CBN at the effective exchange rate, which was 0.5% above the marginal rate, while they were obliged to sell to their customers at 0.5% above the effective rate. This pricing system was in use until the end of March 1987 when a major change was made.

The *Dutch Auction Bidding System (DAS)* was introduced on 2 April, 1987. This was a fortnightly bidding system whereby Authorized Dealers' accounts were debited at their successful bid rates. The difference between this system and the previous ones is

that while the previous system debits the Authorized Dealers' account using the marginal rate established in the market, the DAS allowed for the debiting of the dealers' account using their successful bid rates. Another modification to the previous system was that with the DAS, the Exchange Equalisation Levy of 0.5% in the previous system was increased to 1.0%. The objective of the DAS was to check the frivolous and unrealistic bidding by Authorized Dealers. The DAS was used until the FEM and autonomous markets were converted to just one single unified market - the IFEM, in 1989.

With the introduction of IFEM on 9 January, 1989, the naira exchange rate determination took place through daily auctions. Banks were expected, under this arrangement, to sell their FOREX to customers at not more than 1% above the official rate. The daily auction of FOREX continued through 1989 and 1990 until 14 December, 1990, when the CBN reintroduced the DAS with the use of marginal rate. This shift back to the DAS was meant to check certain practices which led to the persistent pressure on the naira, while also returning the auction to a more competitive FOREX market. The daily auction was changed with this reintroduction of DAS to a weekly auction, to give dealers adequate time to prepare and collate their customers' bids.

Exchange Rates

Given the simultaneous operation of the FFEM and the SFEM, in 1986 two sets of rates emerged - one administratively determined and fixed, the other, under SFEM, determined through the forces of demand and supply. Given that demand for FOREX under the SFEM always exceeded supply, there was a continuous depreciation of the naira in this market. At the first SFEM bidding session, for example, on 26 September, 1986, while the exchange rate in the FFEM was ₦1.5691:US \$1, the SFEM rate was ₦4.6174:US \$1. A further liberalization and decentralization of this dual system to make room for FEM and the autonomous markets, on 2 July, 1987, did not do much to prevent the depreciation of the naira.

This was aggravated by the abuse of this liberalized policy by bankers. Between mid-1987 and December, 1988, a wide premium had been created between the FEM rates and autonomous rates. The Authorized Dealers kept the autonomous rates high, reflecting a faster depreciation of the naira than in the official FEM market. While the autonomous rates during the period January to August, 1988, ranged from ₦4.3611 to ₦6.8800, the FEM rates ranged from ₦4.1740 to ₦4.6440. In December, 1988, the FEM rate was ₦5.3530 while the autonomous rate was ₦8.2856. This development led to the abolition of the autonomous market and the creation of a unified IFEM. However, this did not check the gradual but continuous depreciation of the naira from ₦7.0389 in January 1989 to ₦7.6500 in December that year, although compared to previous periods, this period witnessed a slowing down of the process, at least for some time.

Although the government has taken some macroeconomic measures (these are discussed in the next section) Table 5 shows that the naira had not stopped its monotonic descent up till the end of 1990.

Table 4: Pricing rule in official FOREX market, 1986-90

Period	Pricing Rule
A. 26-09-86 - 20-10-86	Simple Average/Marginal
B. 03-11-86 - 19-03-87	Marginal
C. 02-04-87 - 31-12-88	Dutch Auction/Marginal
D. 09-01-89 -	"

The bureau de change (BDC)

An important development in the Nigerian FOREX market was the establishment of the bureau de change in 1989.

The main objective of this was to enlarge the scope of official market transactions. It was becoming obvious that some businesses that required FOREX, especially the smaller businesses, were unable to cope with the demands and formality associated with procuring FOREX from the official market directed by the CBN. Even when they went through the process, many of such small businesses did not eventually have access to much FOREX. Less documentation had a less formal nature of dealing at the Bureau, made them attractive sources of buying and selling FOREX. It was hoped that creating the Bureau de Change would enhance efficiency in macroeconomic management (CBN, 1989).

Participation in the bureau de change market

Operators in the bureau de change are private entrepreneurs who have been granted legal recognition by government to deal in foreign exchange and provide access to FOREX in a convenient and informal manner. Although only a few licensed operators existed at the end of 1990, returns received from an average of 65 dealers show that the public purchased \$109.60 million from the Bureau in 1990 and the Bureau purchased a sum of ₦111.0 million from the public in 1990 alone.

FOREX is primarily sourced from the private individuals, including business people who are unable to deal at the IFEM. The demand for FOREX at the Bureau is demand generally determines the size of demand in the Bureau.

Table 5: End of period exchange rate in major FOREX Markets (N/US\$)

Date	FEM Rates	Autonomous Rates	Parallel Rates	Bureau de Change Rates
December 1986	3.3166	-	-	-
December 1987	4.1413	4.6928	4.6000	-
January 1988	4.1740	4.3611	4.8560	-
February 1988	4.2611	4.2850	4.5000	-
March 1988	4.3152	4.2470	4.3000	-
April 1988	4.2525	5.8900	4.3000	-
May 1988	4.1838	6.4943	5.4000	-
June 1988	4.0574	6.6660	5.9000	-
July 1988	4.3941	6.3328	6.3500	-
August 1988	4.6440	6.8800	6.6000	-
September 1988	4.6961	5.8115	7.2000	-
October 1988	4.7748	6.0362	7.3250	-
November 1988	5.1479	6.4761	7.5000	-
December 1988	5.3530	8.2856	8.3500	-
January 1989	7.0389	-	8.8500	-
February 1989	7.3828	-	10.5000	-
March 1989	7.5871	-	11.6200	-
April 1989	7.5808	-	11.4300	-
May 1989	7.5051	-	11.3800	-
June 1989	7.3477	-	11.5500	-
July 1989	7.1388	-	10.5500	-
August 1989	7.3000	-	10.2000	10.2000
September 1989	7.3725	-	10.6000	10.7000
October 1989	7.4750	-	10.6000	10.4000
November 1989	7.5454	-	9.2000	9.1000
December 1989	7.6500	-	9.6000	9.5000
January 1990	7.8820	-	9.6000	9.6000
February 1990	8.9225	-	9.3000	9.4000
March 1990	7.9400	-	9.2000	9.3000
April 1990	7.9400	-	9.2000	9.3000
May 1990	7.9400	-	9.2600	9.3500
June 1990	7.9424	-	9.4400	9.4000
July 1990	7.9523	-	9.9200	9.8600
August 1990	7.9623	-	9.7500	9.6800
September 1990	7.9743	-	9.9600	9.7400
October 1990	8.0089	-	9.9700	9.8000
November 1990	8.3200	-	10.4000	10.1000
December 1990	8.7071	-	10.4100	10.1600

Regulation of the bureau de change

It is important to note that apart from the general requirements for being licensed as a Bureau de Change, operators are not subject to the rules and regulations by which the CBN governs the IFEM. However, the CBN, in creating the Bureau, specified that they were only allowed to deal in bank notes and coins and purchase travellers' cheques. They are not allowed to sell travellers' cheques.

Exchange rate in the bureau de change

From their inception there has been a general movement of exchange rates in the BDCs towards that of the parallel market. For example, while the official FEM rate for December 1989 was ₦7.6500, the BDC and parallel rates were ₦9.5000 and ₦9.6000 respectively for the same month. By June, 1990 while the official rate was ₦7.9424, the BDC and parallel rates were ₦9.4000 and ₦9.4400 respectively (see Table 6). This trend continued, with the explanation for this that excess demand for FOREX in the FEM, eventually transferred to the BDC, will tend to attract higher prices. Again, the very simple nature of transactions in this market compared with the FEM, plus the relative lower risk - e.g., fake currency transactions - to the parallel market, make it attractive for consumers to prefer dealing with BDC operators. This drives up the demand and, consequently, the exchange rate.

The parallel market

Although an illegal part of the FOREX market, the parallel market has existed for a long time. This market exists to satisfy the needs for FOREX consumers who are unable to satisfy such needs either in the FEM or BDC. It threatens to continue its existence as long as the official side of the market is underfunded and has a persistent excess demand.

The attraction of patronising this market is the total absence of documentation involved in transactions. This allows for quickness in obtaining or selling FOREX without disclosing much information. However, the high risk associated with dealing with operator in this market is mainly the inability of customers to check the genuineness of local or foreign currencies being exchanged. Consequently, customers may trade genuine bank notes for fake foreign currencies and vice versa. Also, the speed at which the transaction takes place and the absence of bank note counting machines encourages the exchange of an inaccurate number of bank notes, and the informality and absence of record keeping makes it "impossible" for customers to return an inaccurately-counted bunch of bank notes.

Participation in the parallel market

Participants in the parallel market are not defined, especially as there is no legal recognition accorded to operators. As a result of this, any person who has FOREX to sell or who needs to purchase FOREX may become an operator in the market. However, although no legal recognition is given, over time operators in the market informally organize themselves into groups to: 1). monitor the rates from the IFEM and BDC; 2). decide on rates in their (parallel) market; and 3). pass on information about government regulation that may indirectly affect them; etc. The presence of this informal group, although important to members, often does not constrain members from selling their FOREX at their individually determined rate. As a result, spot rates emerge which reflect the relative ability of the sellers and buyers to haggle. Usually, the group's predetermined rate is a benchmark for individual transactions.

Regulation in the parallel market

There is no direct regulation in the parallel market. However, as mentioned earlier, the operators informally create a group that ensures the proper flow of information, monitoring and operation of their market. Although members are not bound by "regulations" from government, the survival of professional operators in the market is often subject to the operators' willingness to subject themselves to the group's non-binding decisions.

Exchange rate from the parallel market

The exchange rate from the parallel market is usually higher than in the official market, and the exchange rate is usually arrived at through a haggling process. Professional operators usually have more information than non professionals. Since deals are struck by individuals, the convergent rate is indeterminate, depending, as it were, on the relative bargaining powers. Generally, the individual transaction rate is influenced by FEM and BDC rates. Evidence from Table 5 indicates a mark-up over FEM and BDC rates. If this is true, it may be impossible to arrive at a homogeneous rate: comparable to catching up with an object moving at a faster pace.

Competitiveness of the markets

It is important at this point to examine critically the FOREX markets to determine the degree of their competitiveness. Competitiveness is conceptualized with convention, i.e., the extent to which buyers and sellers influence the market price and allocation.

The documentation of the features of the various markets undertaken above indicates that none of the three market types are perfectly competitive.

The official market, for instance, is highly regulated by the CBN which is largely a monopoly (its supply is the market supply). The regulation which insists that only a restricted number of Authorized Dealers participate as buyers of FOREX controls entry. There are also several other regulations which control the behaviour of participants. Table 6 documents direct intervention in the market. In this 'controlled liberalization', the competitiveness of the market as defined above is restricted. Besides, our informal inquiries from some of the Authorized Dealers (AD) have revealed that at some point the AD have had to match the CBN's monopoly powers by forming an unofficial cartel within which bid rates and allocations are predetermined. In this context, the market approximates a bilateral monopoly rather than a competitive market. There has been no regulation along the lines of America's Anti-Trust Laws, and even if there were, it is doubtful it could be enforced.²

It is possible that the collusion by AD may be responsible for the government and the CBN intervening and (thereby unilaterally) altering the 'market-determined' exchange rate at certain points, as shown in Table 6. It is clear from the table that besides exchange rate fixing, there have been several interventions.

Given the structure of the official market, particularly with respect to the controls of participants, the CBN monopoly, and the strong potential for collusion by AD, it is almost impossible that the market determined rate would be competitive. And because there is more uncertainty on the side of buyers, given their numbers and hence the excess demand for FOREX (see Table 7), the pressure tends to be on the exchange rate to depreciate over time. This trend, as will become clear, seems to have been strengthened by the fiscal and monetary policies pursued by government during the period.

The Bureau de Change and the parallel market (PM), have been less regulated than the official market. However, the BDC operators still have to be licensed even though the sellers and the buyers of FOREX to and from BDC are not controlled. The FOREX rate however is not determined via a *tatonement* process. On the contrary, isolated BDC tend to fix their individual rates based on: 1. the rate of other BDCs; 2. the official rates; and 3. the parallel market rate. Even though the fixed rates are displayed on display-boards, experience has shown that, similar to parallel markets, the exchange rate can be negotiated. Most patrons may or may not adopt a search procedure. Even some who do, tend to *accept* or *take* the best rate depending on whether they are selling or buying. Personal experience indicates that, as in the official FOREX market, there are strong potentials for collusion among licenced BDC in the same environment. As a result, competitiveness as defined earlier is almost impossible.

The behaviour of operators in PM is not regulated since it is illegal, even though the law is not enforced. To a large extent, there is a strong potential for collusion among professional operators, i.e. the *mallams* who buy and sell FOREX around airports, along the Broad Street (where there is a high concentration of banks) in Lagos and in major hotels: in spite of the fact that FOREX rates are negotiated in isolation. The rates being fixed per individual transaction, seem to be influenced by the bargaining skills of the operators. However, the *mallams* always have floors (when selling) and ceilings (when buying). The floor or ceiling may be influenced by what has been accepted by the group. Given these kind of influences, this market is imperfect. This is in spite of the multiplicity

Table 6: Some Government Interventions in the FOREX Market

Period of intervention	Type of intervention	Specific intervention	Objectives for intervention
22 March 1991; 27 March 1991	Variation in Supply	Equated supply with demand	1. To curb the continuous naira depreciation 2. To combat the excess liquidity in the banking system.
18 June 1987	Restriction of Participation	1. 2 banks restricted on grounds of not needing much FOREX in their operations 2. 10 banks restricted on grounds of being too young to participate	To create more effective FOREX market operations.
18 June 1987	Ban from participation	7 banks disqualified for making improper returns.	To ensure compliance with CBN rules and regulations.
11 December 1986	Price fixing	Allied Bank's (the marginal bank) bid of ₦2.9900/US\$1.00 which would have been the marginal rate was changed to ₦3.200/US\$1.00 by CBN.	To achieve a more realistic rate.
July 1986 - March 1987 April 1987 - December 1988 January 1989 - December 1990	Frequency of Bidding Sessions	Weekly auction Fortnightly Daily	1. To make Authorized Dealers more responsive to their customers' needs. 2. To give Authorized Dealers adequate preparatory time.
See Table 4.2	Changes in Pricing Rules	From average rate pricing to marginal rate pricing to Dutch auction.	1. To make the market more competitive 2. To ensure proper allocation of FOREX 3. To check the frivolous and unrealistic bidding by Authorized Dealers.

Table 7: Annual CBN Supply and Authorized Dealers' Demand for FOREX, 1986-91

	Amount related (\$ million)	Amount offered (\$ million)	Total demand (\$ million)	Excess demand (\$ million)	%Excess demand
26 September- December 1986	871.10	916.00	1,026.41	110.41	10.76
January- December 1987	2,374.10	2,350.00	2,785.45	435.50	15.63
January- December 1988	2,711.10	2,910.00	3,259.97	350.00	10.74
January- December 1989	2,163.20	2,398.00	17,337.90	14,939.90	86.20
January- December 1990	2,501.40	2,646.10	20,196.60	17,550.50	86.90
January-June 1991	1,531.30	1,686.80	4,788.20	3,101.40	64.80

Source: CBN, *Annual Report and Statement of Accounts* (various years).

of buyers and sellers.

Even though all the markets are imperfect, the official market is the most imperfect. The difference in the degree of competitiveness of the markets may have accounted for the observed difference in rates as shown in Table 7 and Figures 2 and 3. Generally, the official rate tends to be smaller than the BDC and PM rates. However, it may be debatable whether factors other than the structure of respective markets account for the differentials. In terms of market share, the official market accounts for the largest share of the FOREX market. This is because the CBN controls the FOREX from the dominant source of Nigeria's FOREX inflow, i.e., oil.

Thus, the official market is the leading market. However, unlike a theoretical oligopoly market where others follow the leader, i.e., take the price dictated by the leader, in the Nigerian FOREX exchange process, the BDC and PM use the leader's price only as a benchmark for mark-up. Their attractions to patrons, relative to the leader, is the complete absence of documentation and bureaucratic red tape: a major feature of the official market. Given the persistent excess demand in the official market, it is to be expected that the BDC and the PM would have adequate (or more) patrons.

The introduction of BDC may have created the potential for leakage of FOREX from the official market to BDC. This is mainly due to the ownership structure of BDC. Certain banks and, even more, their management (in individual capacities), have been known to own BDC. The potential for manipulated rent that this arrangement generates

Figure 2: Comparison of autonomous rates with FEM Rates, (January-December 1988)

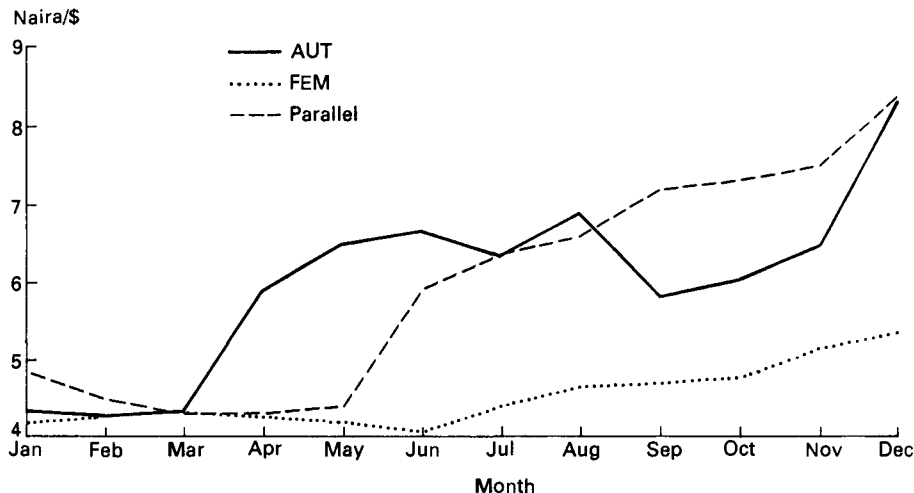
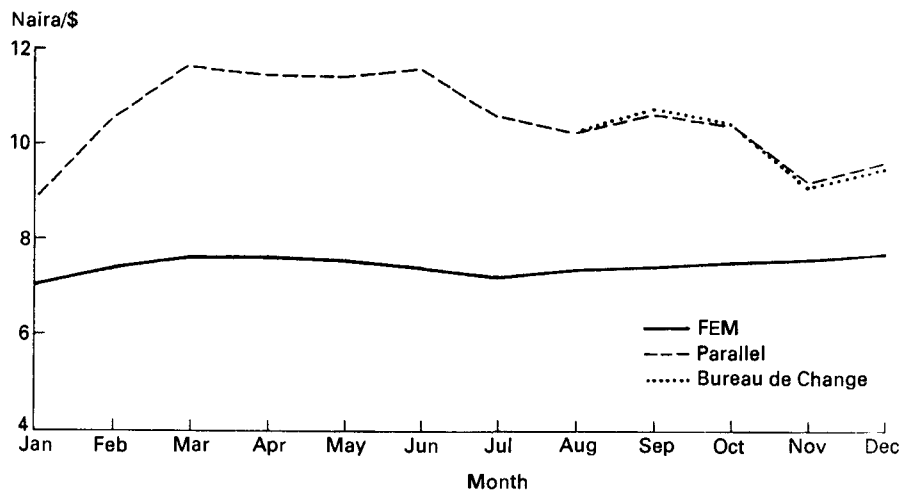


Figure 3: Comparison of dollar/naira exchange rates (January-December 1988)



In fact, in recent times, some ADs have been accused of selling FOREX purchased in official markets to consumers through BDC they own. If the tabloids are to be believed, the boardroom clashes in some of the banks are in fact due to the scramble for the FOREX rent. These allegations need to be closely examined. If indeed BDC are owned by AD or their employees or management, there exists a strong potential for manipulation of FOREX rates. In such an environment, a homogeneous FOREX rate is impossible; and so is a realistic competitive exchange rate.

V. Comparative analysis of pre- and post-reform periods

In Section III we identified the major exchange rate policy adopted by Nigeria between 1960 and 1990. The evidence indicates two major exchange rate regimes: fixed (1960-86) and flexible (1986-90). The shift in 1986 was explained by the weaknesses of the fixed regime in generating a realistic exchange rate for the naira, manifested in the existence of a high level of premium associated with FOREX rates and hence inefficiencies in its allocation and use. The reforms, whose institutional framework was outlined in Section IV, aimed at, among other things, inducing 1. a realistic value of the currency; and hence, 2. a zero premium; and 3. an efficient allocation of FOREX in Nigeria. It is necessary at this juncture to compare the pre- and post-reform periods based on 1. the trend in exchange rates; 2. premium levels; and 3. the FOREX allocation structure. While it may be easier to quantitatively compare pre - and post-period using indicator 1, indicators 2 and 3 would involve a high degree of inferential analysis.

Exchange rate trend

Table 8 shows the average exchange rate trend for the period 1970-90. It should be useful to compare the rates before 1986 with those after it. The pre-reform period exchange rate (ER), although slightly rising from year to year, was relatively stable at an average of ₦0.65:US\$1.00. Although the naira had depreciated over the period before 1979, showing an average depreciation of 3.0%, it depreciated at an average of 10.20% between 1980 and 1983. There was a slight appreciation of the naira in 1984 from its level in 1983, but this was again reversed in 1985 when it depreciated by 14.03%. Between 1986 and 1990 - the period of the SFEM operation - there was a general upward movement of the ₦/\$ exchange rate (see Table 8). Between 1985 and 1986, average depreciation was 49%. A sharp depreciation occurred at the beginning of the auction-market in September 1986 and the naira depreciated even further in 1987, at about 56%. The average annual depreciation over 1985 to 1990 was 31.35%.

The major observation from Table 8 is that the ₦/\$ exchange rate was relatively stable between 1970 and 1985. The second point is that the deviations, upward and downward, were rather small. However, from 1986 to 1990, the exchange rate ceased to be stable and its movement became generally monotonic: upwards. Whether the instability and large depreciation of the currency induced the naira to find its realistic value is an issue that needs to be empirically established. Suffice to say that what is realistic is not only undefined and hence hard to establish, but the differential in the rates of various

Table 8: Selected macroeconomic indicators, 1970-90

Year	% Dep.	Average Exchange	Inflation Rate	Budget Balance	Change in Money %	Credit to Government
1970		0.7142	13.8 ¹	-473.1	-	-
1971	2.85	0.6944	15.6 ¹	199.0	6.2	-19.8
1972	5.54	0.6579	3.2 ¹	96.8	14.4	-2.3
1973	0.0	0.6579	5.4 ¹	296.7	22.5	-4.2
1974	4.54	0.6293	13.4 ¹	1796.8	59.3	-4.1
1975	2.19	0.6158	33.9 ²	-427.4	42.6	-
1976	1.72	0.6266	21.2	-1068.2	33.5	115.6
1977	3.09	0.6466	15.4	-901.5	29.0	111.6
1978	1.81	0.6351	16.6	-2389.0	-3.8	59.3
1979	5.38	0.6027	11.8	1461.7	27.0	3.0
1980	10.20	0.5469	9.9	-1975.2	37.9	4.4
1981	9.63	0.6052	20.9	-3928.6	5.7	84.1
1982	10.09	0.6731	7.7	-5440.4	9.1	59.3
1983	10.32	0.7506	23.2	-3456.0	13.1	50.3
1984	2.16	0.7672	39.6	-2557.6	11.0	15.0
1985	14.03	0.8924	5.5	-3039.7	8.6	0.4
1986	48.48	1.7323	5.4	-8254.3	-1.2	6.5
1987	56.35	3.9691	14.4	-5889.7	17.1	8.3
1988	12.51	4.5367	30.0	-12160.9	43.9	25.9
1989	38.40	7.3651	40.9	-15266.1	35.0 ⁴	10.9
1990	8.37	8.0378	7.5 ³	-23357.0	-	-

Note: ¹From 1970-74 calculated with 1960 as Base Year

²From 1975-89 calculated with 1975 as Base Year

³Calculated with 1985 as Base Year

⁴Up to March 1989 and provisional

Sources: Central Bank of Nigeria; Federal Office of Statistics

markets and the seeming non-competitiveness of the markets suggest that a realistic rate, if it exists, may not have materialized.

While the existence or non-existence of a realistic N/\$ exchange rate is debatable, that the rate has been unstable and persistently increasing is not, given the evidence in Table 5.1. Some analysts have argued that the major explanation is under-funding of the market (see Peterside, 1990, for instance). It is a well-established economic doctrine that when resources are scarce it is to be expected that FOREX is scarce. As a result, rather than blame under-funding, a useful explanation for the trend may be found in the structures of the market as well as the complementary macroeconomic policy of government. Contrary to the government's promise to place a strict control on budget deficits, and also to maintain a tight monetary policy, a quick study of Table 8 shows that over the

period of the SFEM operation, the government largely adopted a expansionary monetary and fiscal policy.

It did not keep its promise to adjust public expenditure to reflect the revenue constraints, with the aim of reducing budgetary deficits. As clearly shown in the table, budget deficits actually increased from year to year between 1986 and 1990. The domestic credit, in the same period, rose very sharply above the 5 to 6% targeted by government in 1986. At the same time, money supply rose, especially between 1988 and 1990. Given the close relationship between aggregate domestic credit, money supply and inflation, the same upward trend in the inflation rate also occurred during the period (see Table 8).

One may conclude that the naira's depreciation was partly caused by the market structures (see Section IV) and partly brought about by the expansionary fiscal and monetary policies which placed undue pressures on the exchange rate via increased aggregate demand for FOREX. "The so-called 'over-bidding' by banks participating in the market was made possible by the failure of the fiscal and monetary authorities to pursue sufficiently restrictive macroeconomic policies" (Oyejide, 1989, p. 19).

Exchange rate premium

The analysis in this section proceeds from the premise that the parallel market rates reflect a realistic and efficient exchange rate. Premium is thus measured by the differential between FEM and parallel market rates. Other measures of premium are the differential between FEM and autonomous rates and between FEM and Bureau de Change rates. It should be noted, however, that the proposition that the parallel rate is the optimal rate is controversial. Given the fact that the official market's share of the FOREX market is much larger, the realistic market rate may lie somewhere between the FEM and parallel market rate.

Table 9 shows the three types of premiums identified earlier. Between December 1987 and December 1988, two different rates emerged from the two market types in operation - the FEM rate and the autonomous rate (see Table 9). The first column in Table 9 shows the premium measured by the differential between the FEM rates and autonomous rates. For example, while the FEM rate for December 1987 was ₦4.1413:US \$1.00, the autonomous rate for the same month was ₦4.6928:US \$1.00, meaning a differential premium of ₦.55. This means that the auction determined rate relative to the autonomous market was subsidised by 55 kobo that month. By May 1988, the official market determined rate of ₦4.8138 was being subsidized by as much as 55% given the autonomous rate of ₦6.4943. This trend goes on through the co-existence of the FEM and autonomous exchange rate determination. Given that the objective of the SFEM was to find the true value of the naira and have a realistic exchange rate, one may conclude by looking at the exchange rate premium of the FEM and autonomous rates that this objective was not achieved during this period.

It is for this reason that some analysts consider the naira to be overvalued still. The premium is even higher in some cases when the differential between the FEM rates

Table 9: Exchange rate premium, 1987-90

Date		1		2		3	
		N	%	N	%	N	%
December	1987	0.55	13.3	0.46	11.1	-	-
January	1988	0.19	4.5	0.68	16.1	-	-
February	1988	0.02	0.6	0.24	5.6	-	-
March	1988	0.03	0.7	-0.02	-0.4	-	-
April	1988	1.64	38.5	0.05	1.1	-	-
May	1988	2.31	55.2	1.22	29.1	-	-
June	1988	2.61	64.3	1.84	45.1	-	-
July	1988	1.94	44.1	1.96	44.5	-	-
August	1988	2.24	48.1	1.96	42.1	-	-
September	1988	1.11	23.8	2.50	53.3	-	-
October	1988	1.26	26.4	2.55	53.4	-	-
November	1988	1.33	25.8	2.35	45.7	-	-
December	1988	2.93	54.8	2.97	55.4	-	-
January	1989	-	-	1.81	25.7	-	-
February	1989	-	-	3.12	42.2	-	-
March	1989	-	-	4.03	53.2	-	-
April	1989	-	-	3.85	50.8	-	-
May	1989	-	-	3.87	51.6	-	-
June	1989	-	-	4.20	57.2	-	-
July	1989	-	-	3.41	47.8	-	-
August	1989	-	-	2.9	39.7	2.9	39.7
September	1989	-	-	3.33	45.1	3.23	43.8
October	1989	-	-	2.88	38.5	2.925	39.1
November	1989	-	-	1.65	21.9	1.55	20.6
December	1989	-	-	1.95	25.5	1.85	24.2
January	1990	-	-	1.72	21.8	1.72	21.8
February	1990	-	-	1.38	17.4	1.48	18.7
March	1990	-	-	1.26	15.9	1.36	17.1
April	1990	-	-	1.26	15.9	1.36	17.1
May	1990	-	-	1.32	16.6	1.41	17.8
June	1990	-	-	1.50	18.9	1.46	18.4
July	1990	-	-	1.97	24.8	1.91	24.0
August	1990	-	-	1.79	22.5	1.72	21.6
September	1990	-	-	1.99	24.9	1.77	22.1
October	1990	-	-	1.96	24.5	1.79	22.1
November	1990	-	-	2.69	25.1	1.78	21.4
December	1990	-	-	1.70	19.6	1.45	16.7

Note: Column 1 = Autonomous - FEM Rate
 Column 2 = Parallel - FEM Rate
 Column 3 = Bureau de Change - FEM Rate

Source: Calculations from Table 7.

for the period December 1987 to December 1988 is compared to the rate from the parallel market for the same period (see column two in Table 9). For example, for September,

October and December, 1988, the government, with its FEM determined rates, was 'subsidizing' the naira by over 50%. Again in 1989, from February to September, the exchange rate premium in reference to FEM vs. parallel market were so high that the government was 'subsidizing' rates from these months by over 40%. It was later on, in 1989 and most of 1990, that such subsidies fell below 26%.

Between August 1989 and December 1990, the official FEM rates were compared to the parallel rates and the Bureau de Change rates. As with the case of high premiums existing between the FEM and parallel market rates, the FEM rates compared to the Bureau de Change rates also showed significant levels of premium. For the months of August (when the Bureau were created), September and October in 1989, the exchange rate premiums were close to or over 40%. Although later months showed lower premiums, as with the FEM/parallel market case, the premiums remained high until December 1990. Using the official FEM rates, therefore, one cannot say that a realistic rate was achieved, especially given the size of excess demand for FOREX in the official market, at lower prices that eventually sought to be satisfied in the Bureau de Change or parallel markets.

Conclusively, all through the period of SFEM with the use of the auction mechanism to determine the exchange rates, the main objective of SFEM -i.e., generating a realistic exchange rate (with zero premium) through the forces of demand and supply - was never realised. This has been due to the issues raised in the last part of Section IV.

Foreign exchange allocation

When SAP was introduced in 1986 a strong argument was made for the need to have a more efficient FOREX allocation. The general belief then was that foreign exchange was not adequately made available and it was not properly allocated. So, one of the objectives of SAP in introducing SFEM was to come up with a better and more efficient method of allocating foreign exchange to the various sectors of the economy.

From independence, the Nigerian government has adopted a strict and well-controlled management of the limited FOREX available. As early as 1962, an Act was put in place to specify how FOREX would be made available to Nigerians who needed to make transactions with foreign bodies. The then Minister of Finance was given the responsibility of controlling the receipts and disbursements of the FOREX, and control measures were outlined to monitor how FOREX was spent. However, the liberal way in which the "preferred zone of the external trade was supervised compared to the non-preferred zone led to the inability of the Act to effectively control the movement of FOREX funds".

By 1967, another Act was designed which lasted until 1971, to allocate FOREX among other things on a priority basis. For this reason, imports were classified into

essential and non-essential commodities, and FOREX allocated on these basis. The problem of too much control and improper classification of commodities led to a more relaxed and liberalized exchange control between 1972 and 1980. This was, of course, supported by the much improved inflow of FOREX as a result of the increase in price of crude oil and the massive accumulation of Nigeria's external reserves. The disastrous consequence of the decline in oil prices in the late 1970s and early 1980s led to the dramatic decline in FOREX reserves, beginning from the second half of 1981. This led to the enactment of the Economic Stabilisation (Temporary Provisions) Act of April 1982. In 1984, a new system of FOREX allocation was designed which suggested allocation be made on global, sectoral, sub-sectoral and monthly ceiling (Odozi, 1986).

To foster a feasible FOREX budget, import licence on a comprehensive scale was adopted in the management of FOREX earned. It was, however, not easy to manage the import licencing scheme given its bureaucratic nature and the level of corruption associated with its use in the allocation of FOREX. By early 1986, it was evident that a more efficient method of FOREX allocation was needed to ensure that the limited reserve was used judiciously. Hence, with the introduction of SAP, and subsequently the SFEM, one of the main objective highlighted in the SAP document was the proper allocation of FOREX to the various sectors of the economy in order to "bring the economy back on the path of steady and balanced growth". Also specified as a main objective of SFEM was "the elimination of the vices associated with the import licence regime" in FOREX allocation.

In the light of the discussions so far, it is interesting to note how many improvements have been made in allocating FOREX to the different sectors of the economy to reflect national need and sectoral contribution to the national objective. Despite the various statements of objectives emanating from different political and socio-economic policies in Nigeria, there seems to be no coherent and operational set of national objectives which guide policy. There are, rather, very many policies and programmes that are made erratically depending on individual leader's 'personal' preferences and mood. In such a situation, it is hardly surprising that these policies and programmes do not outlive any leader.

There is no specific national objective which governs how FOREX should be allocated under SFEM. Rather, everything is left to market forces to determine what proportion of the FOREX supply goes to who or which sector or firm. And of course, equity considerations or developmental considerations are non-market issues. With this in mind, Table 10 shows that between 1986 and 1990, the industrial sector has consistently received a very large proportion of available FOREX in the official market; 77.6% in 1986, 60.3% in 1987, 64.7% in 1988, 68.6% in 1989 and 63.7% in 1990. The next largest proportion went to the finished goods category with 19.6%, 27.9%, 24.0%, 22.5% and 25.3% in 1986, 1987, 1988, 1989 and 1990 respectively. The agricultural sector got a meagre 3%, 5%, 6%, 2% and 6% in 1986, 1987, 1988, 1989 and 1990 respectively. The 'others' category took the remaining proportions.

Table 10: Forex allocation to sectors in percentages

Years	Industrial	Agric	Finished Goods	Others	Total
1960-85	N/A	N/A	N/A	N/A	-
1986	77.60	0.30	19.6	2.5	100
1987	60.3	0.50	27.9	11.9	100
1988	64.7	0.60	24.0	11.1	100
1989	68.6	0.20	22.5	8.7	100
1990	63.7	0.60	25.3	10.6	100

Note: N/A = not available.

Source: CBN *Annual Report*, 1986-90 issues.

This is a far cry from what the SAP was expected to do, i.e. shift resources to tradables. The industrial sector, which consumes most of the nation's FOREX (over 60% and close to 70% in some years) earns little or no FOREX and contributes only marginally to GDP. The agricultural sector, the major non-oil tradable and an important engine of growth, has been less favoured. Allocation to this sector has been, on the average, 4% throughout 1986 to 1990. Without a definite policy to decide what proportion to give to the various sectors, this will continue to be the pattern for years to come, as long as those who need FOREX in the agricultural sector have ineffective demand in FOREX auction market. However, this is consistent with the mechanism of the market. What matters is *willingness* backed by *ability* rather than *need* or *contribution to national development*. Whether a less-developed economy can afford to support this structure of resource allocation needs to be examined. While this is not rigorously examined here, suffice to say that, rather than generate a steady state growth, it tends to worsen allocative structures and, in the process, worsens the inefficiencies in the utilization of scarce resources.

VI. Summary and conclusions

This study has examined foreign exchange management in Nigeria between 1960 and 1990 with the aim of documenting the transformations in the institutional framework of FOREX management.

Foreign exchange management seeks to improve the stock of foreign exchange and induce an efficient allocation of available FOREX in a way that will ensure the achievements of predetermined goals and objectives. It also involves using part of FOREX available to meet international obligations while building on the reserve that will safeguard the domestic currency value in the international financial market.

One of the dominant propositions in the literature is that there is a close relationship between the mechanism of exchange rate determination and the allocation of FOREX to consumers on one hand, and the extent to which predetermined economic objectives are realised on the other.

It is for this reason that the study x-rayed the dominant mechanisms within the specified period.

A government may decide to independently fix the exchange rate price, in which case a control regime is in place, or may allow the rate to be determined through market forces, in which case control is very minimal.

Between 1959 and mid-1986, Nigeria had a fixed exchange rate system with a series of control measures put in place to increase FOREX resources, reduce the FOREX disbursement to non-preferred sectors and preserve the FOREX reserves. However, the control measures applied were not consistently tightened; the controls were stricter during periods of external imbalances. The results of some lapses, coupled with the level of corruption and administrative bottlenecks of the import licensing era, led to 1. massive outflow of the FOREX reserve relative to the inflow; and 2. overvaluation of the exchange rate.

Between July 1986 and December 1990, with the advent of the SAP, a market-determined exchange rate replaced the control regime. The SFEM with the use of the auction as a mechanism for determining the "realistic exchange rate" for the naira was established in September, 1986. Several modifications have been made in the SFEM since its inception: a merger of the First-Tier and Second-Tier markets to form FEM in 1987; an elimination of the inter-bank autonomous market in 1988 which had existed along side FEM; a new system, IFEM, that replaced FEM after the autonomous market was abolished; and the creation of Bureau de Change in 1989 to expand the FOREX market. Also, different pricing policies have been used at different times, ranging from the average rate, marginal rate, and varying types of Dutch auction, all in a bid to determine the naira exchange rate more realistically. Alongside the official markets and the li-

censed Bureau de Change markets, the parallel market for FOREX has existed.

Evidence from the analysis shows that, irrespective of changes made either in types of auction market operated or the pricing policy used, the naira has depreciated tremendously all through the period of study. Moreover, the exchange rate is differentiated rather than homogenised across market types. This seems to have been due to the non-competitive structures of these markets and the segregation of the markets. The non-competitive structures of the markets seem to point to a non-realization of the objective of an efficient exchange rate. The allocations of FOREX which have thus been induced have been shown in Section IV of this paper to be incapable of shifting resources to tradables, particularly non-oil agricultural exports.

The industrial sector, which has received over 65% of the stock of FOREX in the auction market between 1986 and 1990, neither contributes significantly to FOREX inflow nor to GDP. The agricultural sector has over the years of study allocated only an average of 4% of the FOREX available for auction.

The post-SAP era of FOREX management has, as a result, not been as bright as expected. It is obvious that the 'liberalization' of FOREX management has not achieved most of the desired objectives. A realistic exchange rate seems to have eluded the FOREX market, the naira has depreciated to a level where the rationality of continuing with the system is being debated. There has been no clear policy for FOREX allocation that takes into consideration the achievement of certain national objectives - if one exists at all.

Given the linkages between other complementary macroeconomic policies and the character of exchange rate, the government in 1986 promised, among other things, to adequately fund the FOREX auction market, place a tight control on budget deficits, and tighten monetary policy. These are promises that were never kept; yet it was expected that the FOREX market should turn out an undefined "realistic exchange rate". All through the years under study, excess demand has persisted; partly due to government policy and partly due to the structures of the market, and arguably due to the structures of the economy. For instance, in the area of budget management, in contrast to the promise to contain it at the 3% of GDP, it actually averaged 10.3% of GDP in 1986, the very first year of the SFEM operation. This trend continued in later years. At the same time, instead of the promise that aggregate domestic credit will increase only by an average 5 to 6%, it went as high as 12.7% in 1986 and 14.3% in 1987. This even doubled in 1988 to as high as 26.1%. Money supply rose from -1.2% in 1986 to 17.1% in 1987, and by 1988 it had gone up to 43.9%.

Of course, the same upward trend in inflation was noticed given the strong relationship between inflation, aggregate domestic credit and money supply. Given this trend, one begins to question the seriousness of government in its attempt to get rid of the distortions in economy given that it remains a major source of distortions.

Despite the changes made with respect to auction markets, pricing policies, etc., a fundamental step that government must take is to study and understand the inter-relationship of all segments and components of the economy. It should stop treating each problem from each sector in an isolated manner but begin to see the impact of a decision taken in one sector on all others. It is when the economy is viewed in a holistic manner that policy measures taken to solve problems in one area - which is seen to affect

other areas - will begin to make sense and to have some sense of direction.

More recently, in March 1992, the Nigerian Government, after a great deal of ad hoc policy measures to correct the ills of the FOREX market which failed to stem the depreciation of the naira, decided to abolish the auction market. Everyone, including the CBN was, from 5 March, 1992, free to sell FOREX at a price that consumers are willing to pay. Some believe that this decision was political and not motivated by the need to create a better FOREX management. Perhaps, this is correct. Christened 'deregulation' of the FOREX market, this move is as fundamental as the SAP, within which the first deregulation was operationalised. Our analysis in Section IV indicated that the official market approximated a bilateral monopoly and, as such, the allocation of FOREX as well as the determination of the rate of exchange were influenced by the relative bargaining power of each side. This is to be expected, since the pressure of bargaining was initially in favour of the monopoly CBN and against the authorised dealers who were oligopolies. A buyers' cartel was, therefore, a clever response by authorised dealers to counteract the advantage of the CBN over them. Once bureau were allowed to operate, and authorized buyers were licensed to own them either directly or covertly, the advantage of the CBN in a purely market directed allocation and price determination becomes *effectively neutralized*.

What emerges from such a market structure is a situation where the buyers' cartel keeps bid rates stable (at the official market where they are buyers) while ensuring that the rates at the bureau de change (where they are sellers) is not only significantly higher than the purchase price, but over time, the two prices are managed in such a way that the gap between them is *deliberately allowed to widen*. It is deliberate because the gap constitutes rent which is now enjoyed by authorised dealers. This outcome is very similar to what obtained when FOREX was allocated via an import licence, the major differences being: 1. formal private organisations rather than government officials and related individuals now receive the rents; 2. these rents generate less notice and public outcry since they are generated via the market process rather than through government controls; and 3. the various levels of government lose out since in this zero sum-game, the gain of authorised dealers is the loss of the government, to whom FOREX from oil revenue accrue.

Given this, what is now commonly referred to as '5 March' in Nigeria, represents simply, a rational move by the government through the CBN to regain the advantage in Nigeria's chess game of market forces. Tagging the move as deregulation by the government, is therefore, a clever attempt at covering up a rational but regulatory move, in order to regain an advantage it loses via market forces to private organisations (the authorised dealers).³ It could be argued that this step became immediately necessary due to a fiscal deficit, the deficit being the result of, on the one hand, fiscal indiscipline by government and, on the other, petroleum price shocks.

That 5 March is regulatory is indicated by the fact that for several weeks afterwards, even as the demand for FOREX fell drastically by over 70%, the N/\$ exchange rate remained stable at ₦18.60:US\$1.00. Since then, it fell marginally to ₦18.53:US\$1.00 where it has since stabilized, even though the demand has been unstable and at lower

levels than before 5 March.

Implicit in this analysis is the fact that efficiency, conceptualized in terms of rational allocation and a competitive (as we have earlier defined it) price of FOREX, is hardly relevant to the choice of strategy by either the government, the CBN or the private authorized dealers. For the government, the major factor seems to be the objective of relaxing revenue constraint to its expenditure policy while for the private sector, rent and its accumulation and distribution among principal actors are the central issues. If this analysis is true, the logical conclusion is that it is almost impossible to generate either an efficient allocation of FOREX in Nigeria or a competitive exchange rate of the naira.

We must, however, emphasize that the propositions upon which this generalization is based must be empirically evaluated. To do this, it is necessary to examine more rigorously than we have done in this study the linkages between the macroeconomic policy of government and its interventions in the FOREX market. Here we use intervention to represent the set of government's FOREX management and policy over time. This would test, for instance, the hypothesis that Nigeria's macroeconomic policy environment is inconsistent with an efficient FOREX allocation and a competitive exchange rate for the naira.

The second major issue to be studied and evaluated is the interaction between the various markets. A hypothesis that could be tested is that, given the character of the respective markets and their particular linkages, exchange rate convergence is not possible. We believe strongly that these studies would extend considerably the relevance of this study.

Notes

1. Official market as used in this paper refers to the markets that are subject to the rules and regulations of CBN and are directly under the control of CBN, in which case, the Bureau de Change, while a legal FOREX market, is not considered official.
2. It would not only prove difficult to enforce but it would generate strong incentives for corruption. However, even more fundamental is that, being a monopolist, the CBN can hardly complain of uncompetitive market practices. Besides, the CBN has to prove that collusion did indeed take place and this may be very difficult.
3. Rationality is here conceptualized as the defence of self interest. It was in the interest of the government to fix the rate at the rate prevailing in the parallel market thus closing the 'rent gap'. This suggests that rationality and competitiveness need not be mutually inclusive.

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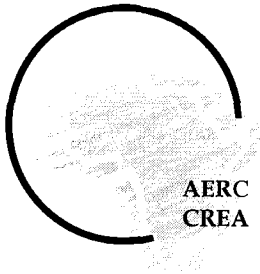
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AFRICAN ECONOMIC RESEARCH CONSORTIUM



P.O. BOX 62882
NAIROBI, KENYA

TELEPHONE (254-2) 228057
225234 215898 212359
332438 225087

TELEX 22480

E-MAIL AERC@elci.gn.apc.org

FAX (254-2) 219308

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